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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER

August 26 2005 ISSUE

11. Summary. Each week, AmEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Manufacturing Leads 2nd Quarter GDP Growth;
 - Oil Prices Accelerate July Inflation but Still Within Targets;
 - Producer Prices Also Increase More than Expectations;
 - Survey Shows a Slow Improvement in Poverty; and
 - Five Consortiums Chosen as Finalists to Build Power Plants.
- End Summary.

MANUFACTURING LEADS 2ND QUARTER GDP GROWTH

12. South Africa's economy grew at a faster pace in the second quarter 2005, primarily due to manufacturing growth of 7.3 percent. South Africa's real gross domestic product (GDP) at market prices on a quarter-on-quarter (q/q), seasonally annualized and adjusted (saa) increased by 4.8 percent in the second quarter of 2005, compared to 3.5 percent growth in the first quarter. The 4.8 percent growth rate exceeded expectations, with the consensus forecast at 4.4 percent, and put the South African government's 2005 GDP forecast of 4.3 percent within target. The manufacturing sector was the main engine of second quarter growth, expanding by 7.3 percent on a seasonally adjusted and annualized basis compared with a first quarter decline of 1.9 percent. Sectors contributing to the second quarter growth include: the manufacturing industry (accounting for 1.2 percent); wholesale and retail trade, hotels and restaurants industry and finance, real estate, and business services industry (0.7 percent each); transport, storage and communication industry (0.6 percent) and agriculture, forestry and fishing; general government services and personal services (0.3 percent each). The seasonally adjusted real value added by the non-agricultural industries increased by 4.7 percent during second quarter following an increase of 3.5 percent in the first quarter of 2005. Manufacturing is the second largest sector of the economy, accounting for 16.4 percent of GDP. The finance sector is the largest sector and is responsible for 18.6 percent of GDP. On a saa q/q basis, real GDP last posted negative growth in the 3rd quarter 1998 (0.9 percent decline), since then there have been 11 out of 28 quarters of growth at 4 percent or above. Source: Reuters, I-Net Bridge, and StatsSA Release P0441, August 23; Business Day, Business Report, August 24.

13. Comment. StatsSA calculates GDP using the production and income approach; the South African Reserve Bank (SARB) compiles GDP using the expenditure approach. The expected release date of the 2nd quarter 2005 SARB Quarterly Bulletin is September 22, where expenditure (consumption, investment and government spending) components of GDP are released. The StatsSA GDP release focuses on industrial production sectors explaining GDP growth. A recent Standard Bank study describes industrial sector growth prospects over the next five years and the structural shifts in the South African economy. Over the past four decades, the South African economy has shifted from growth driven primarily by agriculture and mining to growth driven by wholesale and retail trade, tourism, transport, communications, and services. According to Standard Bank forecasts, high growth in manufacturing, business services, transport and communication, and wholesale and retail trade will generate an average annual GDP growth of 4 percent over the next five years. End comment.

OIL PRICES ACCELERATE JULY INFLATION BUT STILL WITHIN TARGETS

14. CPIX (consumer prices minus mortgage costs) increased 4.2 percent in July, up from June's 3.5 percent increase, chiefly due to a 32 rand cent/liter increase in gasoline

prices. July consumer prices increased 3.4 percent (y/y) compared to June's increase of 2.8 percent. July's increase in targeted inflation (CPIX) was higher than the consensus forecast of 3.9 percent and if oil prices continue to escalate, future interest rate reductions would become less probable. Transport costs accounted for 30 percent of July's increase, although some of the pressure on consumer prices will not affect August inflation. New surveys of rental, electricity and water costs completed in July accounted for 40 percent (30 percent attributed to housing and 10 percent to fuel and power) of the 4.2 increase in CPIX. CPIX is still well within the 3-6 percent targeted range and oil prices remain the main contributor to a possible increase in August's inflation. If oil prices continue to escalate, most forecasters expect interest rates to remain unchanged for the rest of 2005. Prices of services increased faster than goods (6.1 percent vs 3.4 percent) and prices for the lower expenditure groups increased slower than the prices faced by the higher expenditure groups. Source: Investec, CPIX Update; Standard Bank, CPI Alert; StatsSA Release P0141.1; August 24.

PRODUCER PRICES ALSO INCREASE MORE THAN EXPECTATIONS

15. The July Producer Price Index (PPI) rose by 3.6 percent (y/y) higher than a Reuters poll of economic forecasts of 3.3 percent. PPI, which tends to lead consumer inflation by a couple of months, rose by an annual rate of 2.3 percent in June. July domestic and imported goods prices increased 3.0 percent and 5.2 percent, respectively, compared to June's increase of 1.9 percent and 3.4 percent. The higher imported goods price reflects the impact of higher world oil prices. The prices of petroleum and coal products more than doubled, while prices of agricultural, paper, basic metals and tobacco products also showed a higher July price increase compared to the previous month. The last month where overall producer prices declined was April 2004; since then, producer prices have increased an average of 1.6 percent y/y. Since May 2005, producer prices have increased over 2.3 percent, signaling possible future increases in consumer prices. Source: Business Day, Reuters, StatsSA Release P0142.1, August 25.

SURVEY SHOWS A SLOW IMPROVEMENT IN POVERTY

16. A recent All Media Products Surveys (AMPS) survey demonstrated that there has been dramatic change in the income shares of different races since 1994. From 1993 to 2002, black Africans increased their share of the top 10 percent of household income, from under 10 percent just before 1994 to 23 percent in the second half of 2002. "Coloureds" (a distinct South African racial category) also increased their share slightly, while the white share fell sharply from nearly 80 percent to 63 percent. However, the rate of change slowed after 2002. Coloured people continued to advance post-2002, but the shares of all other groups remained static, and may even have fallen slightly among black Africans. According to the AMPS survey, the following trends emerge: (1) a slight but significant decline in black poverty is occurring, due largely to the expansion of social grants; (2) there is a modest but significant expansion of the numbers of blacks in the "not so poor" category of R1,400 (\$220 using 6.4 rands per dollar) to R4,000 (\$625) per month; (3) abject or severe poverty among coloured people is roughly half of what it is among blacks and impacting less than 10 percent of Indians and less than 5 percent of whites; (4) the lower middle class among blacks (R4,000 - R12,000 per month) has not expanded over the two years; and (5) the expansion of the categories of relative wealth of R12,000 and more per month has been more rapid among coloureds, Indians and whites than it has been among blacks. The semiannual AMPS is one of the largest annual measures of income and other socio-economic patterns provided by the All Media Products Surveys (AMPS) of the South African Advertising Research Foundation, using large and fully representative samples of 25,000. The purpose of these surveys is to estimate readership patterns and to relate them to basic social and economic characteristics, including household income per month. Source: Pretoria News, August 23.

17. Comment. The AMPS survey is the only South African expenditure survey conducted each year. The survey and results are private. Official expenditure studies will use the StatsSA expenditure surveys, where both results and methodology are readily available. However, the official surveys are only conducted every five years and their changing methodologies make comparisons over time difficult. End comment.